

**COMMONWEALTH OF MASSACHUSETTS
BEFORE THE
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

An Investigation By The Department Of) D.T.E. 04-1
Telecommunications And Energy Regarding The)
Assignment Of Interstate Pipeline Capacity Pursuant)
To Natural Gas Unbundling, D.T.E. 98-32-B (1999).)

REPLY OF ENERGY EAST SOLUTIONS, INC.
TO THIRD SET OF INFORMATION REQUESTS
OF THE DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Pursuant to the instructions in the letter dated July 14, 2004 enclosing the Third Set of Information Requests from the Department of Telecommunications and Energy (DTE) in the above-captioned proceeding, Energy East Solutions, Inc. (EES) hereby submits its responses below.

Respectfully submitted,

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cc: Parties on the 6-02-2004 service list
Enclosures: Original and 6 copies of filing

DTE QUESTION 3-1

All parties should comment on whether 12.3.2 of the model terms and conditions presently requires LDCs to provide to marketers the baseload and temperature sensitive algorithms use for non-daily metered customers. If your position is that the section does not require LDCs to provide the algorithms, discuss the specific information this section requires the LDCs to provide and whether the model Terms and conditions should be amended to provide the algorithms. Each LDC should include in its comments the current practice by the LDC on providing the algorithms to marketers.

EES Answer DTE-3-1

Section 12.3.2 of the Model Terms and Conditions provides that unspecified "[i]nformation on the consumption algorithm shall be posted on the Company's Website as identified in Section 23.0" without stating what information on the algorithm is to be posted or without expressly addressing whether the actual algorithms themselves are to be provided. Similarly, Section 24.2.2 provides that the LDC will "[p]rovide information regarding, at minimum, . . . consumption algorithms, on its Website or by alternate electronic means", again without explicitly indicating *what* information "regarding" the algorithms is intended.

It would thus appear that the Department could clarify that the information "on" (Section 12.3.2) and "regarding" (Section 24.2.2) the algorithms is intended by the Department to refer to sufficient information for the suppliers to verify the accuracy of the consumption forecasts generated by a company's particular algorithm and adjust its own business operations to better conform actual volumes tendered into the system to the LDC's operational tolerances. At an absolute minimum it would appear to include information necessary allow to suppliers to distinguish between the temperature-sensitive component and the *non*-temperature-sensitive component of a non-daily metered customers' projected consumption.

In construing the section and determining what is intended, the Department may recall the basic linkage between a supplier's willingness to agree to tighter tolerances (and higher penalties for exceeding them) and the supplier's need for *accurate, adequate* and *timely* information necessary to stay within the tolerances and avoid the penalties. In this context, the Department and its Staff may recall that unavailability of the algorithms for Non-Daily metered customers was discussed in the public collaborative process in 1997 and 1998. In February and March of 1998, for example, when there was considerable public discussion of the draft terms and conditions, the unavailability of the algorithms was discussed repeatedly, with the competitive suppliers generally arguing then (as now) that it

was important to make as much operational information available as possible to assist in staying within the operational tolerances. The Department may further recall Attachment B to the Status Report of the Massachusetts Gas Unbundling Collaborative filed with the Department on March 18, 1998, which consisted of the competitive suppliers' "redline" proposed changes to the LDC's version of the Model Terms and Conditions. The competitive suppliers' proposed adding a provision that "UPON REQUEST, COMPANY SHALL MAKE THIS ALGORITHM AVAILABLE TO A SUPPLIER." and included the explanatory note that "[s]ince it is important for suppliers to work with LDCs to manage balancing, it is important for suppliers [to] know how LDC dispatchers respond to and plan for particular weather patterns." Draft Model Terms and Conditions, Discussion Document, Marketers Revisions and Comments, Version: 3-17-98, at 3-17-98 Redlined Page No. 23. The final document approved by the Department November 30, 1998 in Order No.98-32-A (approving the partial Model Tariff Terms and Conditions) did not include this text.

In sum, because it is clear that the need for the algorithms was publicly discussed in some detail in the various meetings and since it would be lower the risks of serving smaller, Non-Daily metered customers by enhancing the quality of the consumption information available to suppliers who serve such customers, it would appear entirely appropriate for the Department to conclude that the existing requirement to post information "on" and "regarding" the algorithms" was intended by the Department to refer to sufficient information for the suppliers to verify the accuracy of the consumption forecasts generated by a company's particular algorithm and adjust its own business operations to better conform actual volumes tendered into the system to the LDC's operational tolerances.

END OF DTE 3-1

DTE QUESTION DTE 3-2

Some marketers state that modifying the Model Terms and Conditions to require true-ups of actual versus delivered volumes on a monthly basis will encourage more accurate forecasting and lower costs for all participants. In this regard, please:

- (A) discuss whether you agree with the statement;*
- (B) discuss any potential problems to implementing monthly true-ups instead of semi-annual true-ups; and*
- (C) address whether monthly true ups would address or minimize the need to adjust the algorithms for temperature sensitive usage? if not, please discuss how the data could be made more accurate.*

EES Answer to DTE 3-2:

(A) discuss whether you agree with the statement;

EES agrees with the statement that requiring monthly true-ups of actual to delivered volumes will *lower systemic price risk* and would represent a material improvement in the business environment. Note, however, that the reduction in the cost of doing business is not because monthly true-ups "encourage more accurate forecasting" (as suggested in the question) but rather because it reduces a price risk for *all* market participants. The price risk at issue here of course is the risk that the *individual* prices of actual purchases and sales of gas during the period to be trued-up will in fact vary from the *average* price used for this reconciliation. Because the *average* price for the period to be trued up is a direct function of all of the prices of the individual days that make up the true-up period, the systemic risk that the prices paid by any individual market participant will vary from the average price will rise with the number of days included in the true-up period.

In a simple analogy, one cannot drown in a pool of water that is *on average* one foot deep if the pool is just one foot square, but one can very easily drown in a pond that is *on average* one foot deep if it is one single *inch* deep over a large surface, yet a dozen feet deep in the deep end.

Thus it is with truing-up a series of daily accounts over a longer period where a given day's price may be six or eight or ten *fold* greater than the price a few days away, as illustrated, for example, in the January of 2004 price information discussed in the reply to this question by Amerada Hess and Select Energy.

Hence, under a semi-annual true-up mechanism, the supplier faces the risk of being effectively forced to buy or sell gas at a six-month average price that may bear no meaningful relationship to the supplier's actual cost of procuring the gas. Sometimes a supplier wins at this lottery; sometimes the supplier loses. The point here is that this uncertainty increases risk and therefore increases the cost of doing business.

It should be further noted that the reduction in price risk by going to a shorter averaging period is a *systemic* reduction, which is to say that it benefits *all* market participants on average by reducing the overall risk that any one participant will be caught in an extreme situation. In this respect, shortening the averaging period is analogous to the systemic reduction in *credit* risk that is obtained through a clearing mechanism that has been the focus of so much discussion at the Federal Energy Regulatory Commission in recent months. When prices vary within a narrow range, the need for rules to minimize system price risk is less significant. But when prices vary as they now do by a factor of nearly ten fold, the public benefits from reducing systemic price risk are commensurately greater.

Note that the LDC *also* enjoys a reduction in price risk from moving to a short true-up averaging period. In effect, the LDC is operating as a bank with "deposits" and "withdrawals", such that the true-up mechanism functions a bit like a clearing house for all transactions by all participants during the true-up period. The longer the period, however, the greater the risk that one or more market participants will not be able to honor any resulting obligations. Now, if the LDC were required to bear the risk that a market participant with an adverse position might not in fact true-up, then the LDC would have the same interest as all other market participants in minimizing that risk. If, however, the LDC is allowed to "mutualize" or share the risk of default by effectively requiring all remaining market participants to bear the risk of failure by any one of them, then it will no longer have the same interest in minimizing the price risk and its interest in the appropriate length of the true-up process will probably be affected by other considerations.

(B) discuss any potential problems to implementing monthly true-ups instead of semi-annual true-ups;

The suppliers' risk from the current semi-annual true-up approach is greatest to the extent that it serves **Non**-Daily Metered customers (which comprise, of course, the vast majority of the smaller customers). The reason is that Daily-Metered customers are (appropriately enough) metered daily so that the supplier does not have to "guess" at their consumption. It is with the Non-Daily Metered customers -- customers for whom nominations are based ultimately on the algorithms discussed elsewhere -- where the supplier faces the greatest

risk of being forced to effectively buy or sell gas (through the true-up mechanism) at a price that is a meaningless average of six months that may bear no meaningful relationship to the supplier's actual cost of procuring the gas. Hence, the availability on some LDCs of monthly true-ups for Daily-Metered customers doesn't really address the problem. Conversely, it is the *Non-Daily* metered customers who should see the greatest benefit from going to the monthly true-up as this cost barrier to serving these customers is diminished.

This further underlines the importance of providing greater information about the operation of the algorithms -- at a minimum breaking down the temperature sensitive and non-temperature sensitive components the way that Bay State does, for example.

In implementing monthly true-ups, there may well be some implementation details (e.g. adjusting for accounts that are not currently managed on a calendar month cycle, etc.). These, however, should be one-time adjustments to the new system, the cost of which should be minor compared with the long-term systemic reduction in price risk in serving the Non-Daily metered customers.

(C) address whether monthly true ups would address or minimize the need to adjust the algorithms for temperature sensitive usage? if not, please discuss how the data could be made more accurate.

As noted above, both monthly true-ups and better disclosure of the algorithms for Non-Daily metered customers reduce the risk of serving customers (and especially the Non-Daily metered customers as explained above). Both approaches should be implemented. In response to the question how data could be made more accurate, while the cost of daily metering has fallen in recent years, it is still significant and is not economically justified for many smaller customers. The objection is not to the use of algorithms for the non-daily metered class of customers, but to inadequate and inadequately *disclosed* algorithms.

END OF DTE 3-2

DTE QUESTION DTE 3-3

A. Should the Terms and Conditions concerning holiday nomination deadlines be modified to synchronize the nomination schedule over holiday periods with current gas supply industry practice in Massachusetts? Alternatively, does the term "best efforts" by the LDCs as referred to in Section 11.3.3 and Section 12.3.4 of the Terms and Conditions need further definition to standardize the practices among Massachusetts LDCs? Discuss whether a clarification to the terms and conditions that equates the LDC's "best efforts" as referred to in Section 11.3.3 and Section 12.3.4 with industry-standard trading and nomination schedules for holidays and weekends would satisfy the marketers' concerns regarding non-standardization of nomination schedules.

EES ANSWER DTE 3-3.

What EES has requested in is earlier comments in this docket was a fairly straightforward matter of synchronizing the LDCs' schedules for nominations leading into holidays with the schedule used by the Intercontinental Exchange ("ICE"). Hence the request was to adapt the nomination times and days for *standard* nominations around holidays, which is of course particularly important with four-day breaks during the peak season as frequently occurs with the Christmas and New Year's holidays. EES believes that this would be a worthwhile improvement in the market rules and should be implemented.

With regard to the term "best efforts" in the referenced sections of the Model Terms and Conditions about which the Department inquires here, this provision is really intended to address a very different issue, which is the acceptance of what are effectively *non-standard* nominations (*on* weekends, *on* holidays, and *on* non-business hours). The Model Terms set a standard that the LDCs will use their "best efforts" to accept such non-standard (weekends, holidays, and non-business hour) nominations. EES has not requested any change to the LDCs' practices of dealing with such non-standards nominations and does not believe any clarification or change in the best-efforts standard is needed.

END OF DTE 3-3
